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In the Supreme Court of the United States

OCTOBER TERM, 1993

ETHEL M. WARDA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether transfers of farm lands from petitioner to her son in 1979, 1980, 1982, and 1983 were taxable gifts, subject to the federal gift tax.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 15 F.3d 533. The opinion of the Tax Court (Pet. App. 67a-90a) is unofficially reported at 63 T.C.M. (CCH) 1894.

JURISDICTION

The judgment of the court of appeals was entered on January 26, 1994. The petition for a writ of certiorari was filed on April 22, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Ethel Warda is the daughter of William Matthews, who owned several parcels of Michigan farm land at his death in 1953. Matthews died on July 1, 1953, having executed two wills and a separate codicil. In connection with unrelated proceedings, petitioner's husband, Anthony Warda, had been appointed legal guardian of their then minor son, Henry. Pet. App. 2a-3a; App. 53-55, 56, 62-64.[1]

The first will, executed on October 2, 1950, left the bulk of Matthews' estate—after payment of spousal obligations,[2] debts and taxes—to his daughter, petitioner. In the event that Matthews survived petitioner, this first will left the residue of his estate in trust for the benefit of his grandson Henry. Jt. Exh. 8-H; App. 53-55. The second will, dated December 4, 1950, was similar except that it directed the bulk of the estate to be placed in trust, with payment of the net income (after discharging debts and spousal obligations) to petitioner for life and upon petitioner's death to pay over the corpus of the trust to Henry. Jt. Exh. 9-I; App. 56.

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[1] "App." references are to the joint appendix filed with the court of appeals. "Supp. App." references are to the supplemental appendix filed with the court of appeals. "Jt. Exh." references are to the original record on appeal.

[2] Matthews' first wife died in 1947. He remarried in 1950. He and his new wife executed a post-nuptial agreement reciting that each owned substantial real and personal property and that he agreed to maintain and support his wife in the manner to which she was accustomed as long as she remained his wife or widow and to pay all her medical and hospital care expenses. Matthews and his wife otherwise waived and disclaimed any spousal interest in the property of the other. Pet. App. 2a-3a; App. 53-55, 56, 62-64, 488-489.

Two years after executing the second will, Matthews executed what purported to be a codicil to the *first* will (Jt. Exh. 10-J; App. 56). The codicil, which named a new executor, states: "I hereby ratify and confirm [the first] Will and Testament in all respects not inconsistent with the terms of this codicil." Jt. Exh. 10-J.

After the death of Matthews on July 1, 1953, the attorney who prepared Matthews' second will submitted it for probate. On July 10, 1953, the attorney who prepared the codicil to Matthews' first will filed an objection to the admission of the second will. He further petitioned for entry of the first will and codicil to probate as the Last Will and Testament of Matthews. App. 56-57, 89.

On July 25, 1953, a Settlement Agreement was reached and executed by all parties, including Anthony Warda as guardian of Henry. Under this settlement, the first will, as amended by its codicil, was to be admitted to probate (Pet. App. 3a; App. 58, 92-96). The Probate Court approved and authorized execution of the Settlement Agreement by Anthony Warda, on behalf of Henry, based on Warda's assertion that probate litigation would dissipate the assets of the estate and that it was in Henry's interest that the settlement be made (App. 58, 118-120, 121-122). Matthews' first will of October 2, 1950, and the codicil of November 19, 1952, were admitted to probate on August 10, 1953 (*id.* at 135-137).

By the time the administration of Matthews' estate was closed on July 11, 1955, Henry had reached his majority. He never challenged or questioned the settlement reached on his behalf in 1953. Warda was discharged as Henry's guardian by order of January 26, 1956, after Henry, then an adult, executed a release and discharge of Warda "from all liability on account of said

guardianship, absolutely and forever" (Pet. App. 12a; App. 491-501).

2. Henry thereafter took over the management of the farm properties at petitioner's request. In 1961, Henry and his wife and children moved into the main farm house. Petitioner moved to a smaller house on the farm. Petitioner received a share of the crop proceeds each year, as well as additional support from Henry and his wife. As the years passed, petitioner transferred the properties that she had inherited from her father to Henry or to Henry and his wife. The farm home was transferred in 1962, and the farm land and other properties were transferred in 1979, 1980, 1982, and 1983. Pet. App. 3a, 74a-78a.

In an audit of Henry's federal income taxes, the Internal Revenue Service inquired concerning the transfers of these properties. Henry first contended that he had purchased the properties from his mother. Petitioner supported Henry's claim with a notarized letter to a revenue agent stating that she had conveyed the properties to Henry as consideration for his work on the family farm. After Henry employed an accountant, he recharacterized the transactions as gifts rather than as sales. Petitioner then also reversed herself and executed a series of affidavits in which she swore that the land transfers were gifts rather than sales. Pet. App. 3a-4a, 76a-77a; App. 527-542.

3. The Internal Revenue Service asserted gift tax deficiencies against petitioner for 1979, 1980, 1982, and 1983, arising from the transfers of farm lands to Henry. Additions to tax for failure to file federal gift tax returns for those years were also asserted. Petitioner sought review of these deficiencies in the Tax Court.

In January 1992, the Tax Court upheld the deficiencies except with respect to the transfer of the farm home in

1962, a year not properly before the court. The court concluded that petitioner had lawfully acquired title to the properties by inheritance under the 1953 probate court judgment (Pet. App. 80a). The court rejected petitioner's assertion that the transfers of these properties were sales, rather than gifts, stating that the testimony of the interested parties was not specific, persuasive, or conclusive, but was "self-serving and unworthy of belief" (*id.* at 82a). The court instead accepted the sworn affidavits filed by petitioner on the occasion of Henry's income tax audit stating that the transfers were gifts and that no consideration had been paid (*ibid.*). The court therefore held that the transfers during the years in question were for less than an adequate and full consideration and represented taxable gifts (*id.* at 83a). The court further held that petitioner's failure to file federal gift tax returns was the result of her willful neglect and not due to any reasonable cause (*id.* at 88a-90a).

4. While the Tax Court proceedings were pending, petitioner commenced an action in a Michigan probate court to obtain a declaration that she had defrauded Henry in the 1953 probate proceedings and that all the property she had received under her father's will was held by her under a constructive trust for the benefit of her son. The district counsel of the Internal Revenue Service learned of this petition and informed the probate court of the pending Tax Court proceedings. The Internal Revenue Service did not otherwise participate in the state court probate proceeding (Pet. App. 4a-5a).

The Tax Court decision sustaining the taxes imposed on petitioner's transfers of property to her son was filed in January 1992 (Pet. App. 67a). Eleven months later, in December 1992, the Michigan probate court entered a decision on petitioner's application without an

evidentiary hearing (*id.* at 17a-18a). The state court concluded that petitioner had defrauded her son and imposed a constructive trust for the benefit of Henry upon the property petitioner had received under her father's will (*id.* at 14a-66a).

5. The court of appeals affirmed the Tax Court decision. The court did not question the Tax Court's findings of fact based upon its appraisal of the credibility of the witnesses before it. The court concluded that the 1953 probate court judgment was validly entered based on a settlement that avoided the expense of litigation and which the probate court adopted as "just and reasonable with respect to Henry's interests" (Pet. App. 10a). The court reasoned that, even if Henry's father and attorney had a conflict of interest in proposing the settlement in 1953, the "crucial issue" is whether the probate court had a valid basis in 1953 for determining that the first will and codicil were legally valid and that the settlement was reasonable (*id.* at 10a & n.5). The court of appeals concluded that it did, and that the 1953 probate judgment therefore validly transferred the properties to petitioner (*id.* at 11a-13a).

As an additional basis for its holding, the court also noted that "it is too late in the day for [petitioner] to advance [the] new theory" that she had defrauded her son in 1953: "She inherited substantial wealth many years ago, and she benefited from the ownership of that property for many years as a result of the 1953 probate court's acceptance of her original theory. She cannot prevail again by arguing the opposite in court now." Pet. App. 10a-11a. The court stated that petitioner's inconsistent positions were an assault on the integrity of the judicial system that, "under the doctrine of judicial estoppel, * * * must fail." *Id.* at 11a.

ARGUMENT

The tax deficiencies asserted against petitioner were correctly upheld in this case. Further review of petitioner's renewed contention that she defrauded her son is not warranted.

1. When petitioner sought Tax Court review of the deficiencies asserted in this case, that court acquired exclusive jurisdiction over petitioner's gift tax liability for the years in question. 26 U.S.C. 7422(c). In those proceedings, petitioner had the burden of proof. See *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935). The findings of the Tax Court upholding the asserted deficiencies—and determining that petitioner had lawfully acquired title to her father's properties by inheritance under the 1953 judgment of the state probate court—are supported by the record and are not clearly erroneous.[3] The Tax Court's decision was properly upheld for that reason alone. See, *e.g.*, *Anderson* v. *City of Bessemer City*, 470 U.S. 564, 573-576 (1985).

2. As the court of appeals explained, petitioner's belated claim that she defrauded her son in 1953 was properly rejected by the Tax Court. The "critical issue" concerning the correctness of the 1953 probate court judgment was whether the settlement represented a fair resolution of the disputed legal question concerning the ability of a codicil to revive a will that had been superseded by intervening events. See page 6, *supra*. Because there was no authoritative state court decision on that issue in 1953 (Pet. App. 10a n.5), and because litigation of that issue would have depleted the assets of

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[3] This Court has held that the parties to a settlement of a will contest take the funds or property that they receive in the capacity that gave them ground for the contest. *Lyeth* v. *Hoey*, 305 U.S. 188 (1938).

the estate (*id.* at 3a, 10a), the settlement fairly protected the son's interest in ultimately obtaining an interest in the testamentary property—a fact that subsequent events (including the son's current ownership of that property) have verified.

The further point made by the court of appeals—that it is now too late for petitioner to seek a benefit from the assertion that she defrauded her son in 1953—was not necessary to its conclusion. It was correct, however, for the court to point out that, because petitioner held title to this property, and received income from the property, for approximately thirty years before she transferred it to her son, her ownership for federal tax purposes was sufficiently established without regard to whether any third party held some inchoate claim to the property prior to its transfer. As this Court stated in an analogous context in *United States* v. *Irvine*, No. 92-1546, slip op. 16 (Apr. 20, 1994), the "federal gift tax is not struck blind" by state-law legal fictions. The gift tax looks to the taxpayer's substantive enjoyment of ownership rather than to fictions adopted under state law that purport retroactively to reallocate ownership, such as "disclaimers" (*ibid.*) and "constructive trusts." As the court of appeals explained, petitioner "inherited substantial wealth many years ago, and she benefited from the ownership of that property for many years" (Pet. App. 10a-11a). At the time she transferred that property to her son in the early 1980's—approximately a decade before she sought to obtain an inconsistent probate court judgment declaring her ownership to be the result of her fraud—petitioner unquestionably held both formal title and a "not insubstantial" claim to substantive ownership of the property (*id.* at 12a). The court of appeals correctly concluded that the gratuitous

transfers of the economic interest she had long enjoyed in these properties represented taxable gifts.

The court of appeals was also correct in observing that petitioner should not be allowed to "abus[e] the judicial process through cynical gamesmanship, achieving success on one position, then arguing the opposite to suit an exigency of the moment." Pet. App. 8a-9a, quoting *Teledyne Industries, Inc.* v. *NLRB*, 911 F.2d 1214, 1218 (6th Cir. 1990). The court's suggestion that the doctrine of "judicial estoppel" precluded such "cynical gamesmanship" by petitioner was only an alternative holding in this case, however, for the court expressly and correctly further held that petitioner's ownership interests in the property were sufficient to make her transfers subject to the federal gift tax. Pet. App. 13a. This case thus does not present a proper occasion for the Court to address the conflict that petitioner claims to exist (Pet. 15-29) concerning the scope of the doctrine of judicial estoppel.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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